Managerial entrenchment, corporate social responsibility, and earnings management

García-Sánchez, Isabel-Maria; Hussain, Nazim; Khan, Sana; Martínez-Ferrero, Jennifer

Published in:
Corporate Social Responsibility and Environmental Management

DOI:
10.1002/csr.1928

Received: 7 September 2019 | Revised: 8 December 2019 | Accepted: 15 February 2020

DOI: 10.1002/csr.1928

RESEARCH ARTICLE

Corporate Social Responsibility and Environmental Management

WILEY

Managerial entrenchment, corporate social responsibility, and earnings management

Isabel-Maria García-Sánchez[1] | Nazim Hussain[2] | Sana Akbar Khan[3] | Jennifer Martínez-Ferrero[1]

[1]University of Salamanca, Salamanca, Spain

[2]Faculty of Economics and Business, University of Groningen, Groningen, The Netherlands

[3]ESDES, Lyon Catholic University, Lyon, France

Correspondence
Nazim Hussain, Faculty of Economics and Business, University of Groningen, Nettelbosje 2, Groningen 9747 AE, The Netherlands.
Email: n.hussain@rug.nl

Abstract

Many studies have examined the direct relationship between the two corporate practices: corporate social responsibility (CSR) and earnings management (EM); however, the results remain heterogeneous. To achieve the consensus, this study builds upon the classical agency theory and examines the role of managerial entrenchment in creating organizational facades related to CSR and EM. More specifically, it examines the relationship between CSR performance and EM in the presence of managerial entrenchment and the direct effect of managerial entrenchment on CSR decoupling. In doing so, this article provides evidence of a previously underappreciated yet fundamentally important aspect, that is, managerial entrenchment, that may significantly affect the quality of earnings as well as the level of alignment between CSR disclosure and performance. Our analyses of longitudinal data of an international sample for the period of 2007–2016 supports that managerial entrenchment significantly moderates the relationship between CSR performance and EM. Furthermore, our study reveals that entrenched managers decouple CSR disclosure and performance.

KEYWORDS

accrual-based earnings management, corporate social responsibility decoupling, managerial entrenchment, nonfinancial disclosure, real earnings management

1 | INTRODUCTION

The central idea of this article is to understand the relationship between the existence of managerial entrenchment and various corporate strategies concerning the transparency of financial and nonfinancial disclosure. Managerial entrenchment is a phenomenon that can be understood as a managerial power to expropriate wealth (Florackis & Ozkan, 2009). It is a form of agency conflict between shareholders and managers. In the face of ineffective monitoring mechanisms and availability of opportunities, managers may follow their interests at the expense of investors. They seek to meet personal objectives to preserve their job and avoid the scrutiny of stakeholders rather than achieve corporate goals (Cespa & Cestone, 2007). Based on the agency theory, this study examines the effects of managerial entrenchment on two firm's (un)ethical practices: earnings management (EM) and corporate social responsibility (CSR).

EM is an alteration of accounting numbers to "mislead stakeholders about the underlying economics that depend on reported accounting numbers" (Healy & Wahlen, 1999, p. 368). CSR, on the other hand, is a firm's "obligation to constituent groups in society other than stockholders" (Jones, 1980, p. 59). Firms respond to society by performing internal and external CSR actions (Hawn & Ioannou, 2016). In other words, they may bring internal changes and engage in initiatives to improve their CSR performance and also disclose the same to external stakeholders at the same time.[1] However, the two actions may not always align and managers may intentionally disconnect CSR disclosure and performance, which is referred to as CSR gap or CSR decoupling (Tashman, Marano, & Kostova, 2019). We argue that manipulation of earnings and the CSR gap, both are unethical, and may give a room to entrenched managers to act in their best interests. Based on this proposition, we aim to study the direct and moderating effect of managerial entrenchment on these practices. Specifically, we examine the relationship between CSR performance and EM, the moderating impact of managerial entrenchment on this relationship, and finally, the relationship between managerial entrenchment and CSR decoupling.

From the financial transparency perspective, we argue that managerial entrenchment promotes a positive association between CSR performance and EM. Although manipulation of earnings is an unethical behavior (Scholtens & Kang, 2013), managers, in practice, have strong motives for EM to meet or beat the market expectations. The research concerning EM determinants, in general, (Bilal & Komal, 2018; García-Meca & Sánchez-Ballesta, 2009; Lin & Hwang, 2010) and CSR performance as a determinant of EM, in particular, has gained a tremendous scholarly attention during the last couple of decades (see, e.g., Chen, Gotti, Kang, & Wolfe, 2018; Chih, Shen, & Kang, 2008; Gao & Zhang, 2015; Hong & Andersen, 2011; Kim, Park, & Wier, 2012; Liu, Shi, Wilson, & Wu, 2017; Prior, Surroca, & Tribó, 2008). However, the consensus related to the nature of the relationship between CSR and EM has not been achieved. While some researchers report a negative association (see, e.g., Grougiou, Leventis, Dedoulis, & Owusu-Ansah, 2014; Martínez-Ferrero, Banerjee, & García-Sánchez, 2016), others note opposite results (see, e.g., Kim et al., 2012; Hong & Andersen, 2011; Liu et al., 2017). On these lines, Liu et al. (2017) indicate that assuming a direct relationship between the two could be misleading. On the other hand, Florackis and Ozkan (2009) mention that entrenched managers in firms with weak governance tend to use suboptimal strategies, for instance, EM. The literature also suggests that these managers extensively engage in CSR activities to handle stakeholder pressure (Surroca & Tribó, 2008; Villarón-Peramato, Martínez-Ferrero, & García-Sánchez, 2018). It gives a hint that managerial entrenchment is a relevant factor that can play a critical role and explain the conflicting results of CSR performance-EM relationship. Therefore, this study analyzes the moderating effect of managerial entrenchment on the link.

Moreover, recent literature shows that with increased awareness among stakeholders, modern managers face conflicting societal and financial market demands to be profitable as well as ethical and law-abiding (Martínez-Ferrero et al., 2016; Vansant, 2016). To meet contradictory expectations, managers often tend to cuckold stakeholders (Crilly, Zollo, & Hansen, 2012; Jensen, 2004) and create organizational facades. Organizational facades are a "symbolic front erected by organizational participants designed to reassure their organizational stakeholders of the legitimacy of the organization and its management" (Abrahamson & Baumard, 2008, p. 437). Limited shareholders' rights to influence the strategic managerial decision facilitate managers to create such façades (Bebchuk, Cohen, & Ferrell, 2009). EM is one of the organizational façades used by entrenched managers to misrepresent financial performance. Prominent literature also acknowledges that stakeholders use CSR performance information to assess the financial reporting quality (Wang, Cao, & Ye, 2016) that motivates entrenched managers to use CSR as a means to mask their irresponsible activities like EM (Gond, Palazzo, & Basu, 2009; Grougiou et al., 2014; Prior et al., 2008). It allows entrenched managers an opportunity to invest more in CSR to camouflage their unethical practices or create CSR-related organizational facades (Cho, Laine, Roberts, & Rodrigue, 2015) by decoupling CSR disclosure and performance.

Thus, it is pertinent to study the role of managerial entrenchment not only in explaining the CSR performance-EM relationship but also in creating CSR decoupling. The empirical literature, however, does not examine this role. This article fills this void and adopts a more nuanced approach to provide fact-based evidence about the moderating and direct role of managerial entrenchment. We further contribute to the literature by examining CSR performance and EM link under the different levels of managerial entrenchment.

More specifically, we investigate whether the EM of firms with high levels of CSR performance and less managerial entrenchment is lower than those with low levels of CSR performance and high managerial entrenchment. Our analysis of longitudinal data of large listed companies for a period of 2007–2016 confirms that, on the one hand, entrenched managers opportunistically invest in CSR to camouflage their EM strategies and, on the other hand, they create a gap between actual CSR disclosure and CSR performance. We also note that the gap is positively and significantly linked to the various measures of EM.

Our study is novel in the sense that it identifies one of the causes of heterogeneity and hence contributes to the existing CSR-EM literature (Chen et al., 2018; Chih et al., 2008; Gao & Zhang, 2015; Hong & Andersen, 2011; Kim et al., 2012; Liu et al., 2017; Prior et al., 2008). Our study validates the concept of internal and external CSR actions in line with Hawn and Ioannou (2016) and suggests that weak governance increases the gap between the two actions. We also contribute to the literature of organizational facades (Cho et al., 2015) and study the link between two forms of organizational facades, that is, CSR decoupling and EM. By doing so, we extend the recent work on the CSR gap (see, Sauerwald & Su, 2019; Tashman et al. 2019). We reveal that firms decouple CSR actions to camouflage other hypocritical strategies.

The remainder of this article is structured as follows: The next section discusses the fragmentation in the existing literature, provides theoretical underpinnings, and presents the hypotheses. We describe the research method and data in the third section, include the results and its discussion in the fourth section, and conclude our study in the fifth section.

2 | THEORETICAL BACKGROUND AND HYPOTHESES DEVELOPMENT

Classical agency theory literature supports affective corporate monitoring to avoid wealth expropriation by the managers (Florackis &

Ozkan, 2009). Agency scholars agree that managerial entrenchment is a function of weak governance. Weak governance gives room to managers to prioritize their personal goals over the goals of the firm (Bebchuk et al., 2009). On the other hand, it is also linked with low-quality financial reporting practices (Klein, 2002). It shows that there is a relationship between managerial entrenchment and EM (Zhao & Chen, 2008). The basic premise of this stream of literature is that entrenched managers avoid difficult decisions and costly efforts. Therefore, they try to conceal their inefficient management of a strategy or improperly reaped private benefits. We argue in this article that besides manipulation of earning numbers (Zhao & Chen, 2008), CSR can also serve as a concealer.

Similarly, stakeholder theory also discourages the managerial opportunism and misrepresentation of financial and nonfinancial performance. In this respect, Qian, Gao, and Tsang (2015) and Kim et al. (2012) argue that any socially unacceptable strategies, including EM, can seriously harm a firm's relationship with its stakeholders. Like the stakeholder theory, agency theory posits that manipulation of earnings is an act of deception about the actual financial performance of the firm and causes agency problems among managers and shareholders (Scholtens & Kang, 2013). On the other hand, Hussain, Rigoni, and Orij (2018) argue that real CSR engagement can reduce agency conflicts. Similarly, the delineation provided by Carroll (1979) about socially responsible firms suggests that firms should be profitable, but ethical, law-abiding, and good corporate citizens at the same time.

Although firms have a responsibility to undertake social or environmental initiatives to take care of shareholders as well as non-shareholding stakeholders, they can use CSR as a masking tool (Prior et al., 2008). Hawn and Ioannou (2016) point out that firms perform two types of CSR actions: internal CSR actions reflect a firm's adoption of CSR-related policies or practices while external CSR actions reflect a firm's communication or reporting behavior. CSR performance is an example of internal actions and is the "measurement of how socially responsible a firm behaves and what CSR activities a firm undertakes (Hinze & Sump, 2019, p. 128). Whereas CSR disclosure is an example of external actions, and it communicates a firm's CSR performance to various stakeholders to gain visibility. Since both CSR performance and disclosure can generate legitimacy (Hawn & Ioannou, 2016), they are potent means for managers to pursue their personal goals. It is more apparent with a recent debate on CSR decoupling (Sauerwald & Su, 2019; Tashman et al., 2019).

Under similar assumptions, Christensen, Morsing, and Thyssen (2013) and Pope and Wæraas (2016) argue that if a firm demonstrates an enhanced engagement in CSR, its claims can elevate the stakeholders' expectations and resultantly mount the pressure to be responsible in other corporate practices. Likewise, Bertels and Peloza (2008) maintain that CSR performance can increase the multitude of pressure by attracting pressure groups' attention toward a firm's policies and practices. If entrenched managers invest more in the CSR activities to mask unethical practices (Prior et al., 2008), then the firm can lose its legitimacy in the financial market. Recently, Hawn and Ioannou (2016) note that firms that promote ethical behavior only symbolically have a lower market value than the firms with a minimum or no gap between their disclosure and performance. The theories discussed above discourage opportunistic behavior of managers and the devious use of CSR as well as EM (Kim et al., 2012). In line with the agency perspective, we argue that true CSR engagement is negatively linked with EM. However, entrenched managers may use CSR as a masking tool for hiding their unethical reporting behavior. Moreover, we expect that managerial entrenchment may also affect nonfinancial disclosure transparency.

2.1 | Corporate social responsibility and earnings quality[2]

The research in the CSR-EM nexus has recently received considerable attention in the accounting and management fields. One prominent research strand suggests that firms with high levels of CSR commitment behave more ethically than those with low levels of CSR commitment (Gao & Zhang, 2015; Hong & Andersen, 2011). Likewise, Chen et al. (2018) and Wang et al. (2016) note that responsible companies constrain their use of corporate EM strategies, thereby delivering a higher earnings quality (EQ) in their financial reports. On the other hand, there is also burgeoning literature that shows a negative link between CSR and EQ (Grougiou et al., 2014; Martínez-Ferrero et al., 2016). The later strand shows that companies with a lower level of EQ often exhibit higher levels of CSR disclosure, voicing that firms opportunistically use CSR as a tool to change the perceptions of investors while engaging in EM in reality. Kim et al. (2012), however, promote the first view and argue that it is unethical when managers invest in CSR to conceal their EM strategies. They further point out that deceiving shareholders or nonshareholding stakeholders is against the virtues of corporate citizenship. In line with Kim and colleagues, many others support a positive relationship (see, for example, Hong & Andersen, 2011; Liu et al., 2017).

The review of existing literature shows that there is an apparent competition among these two schools. Liu et al. (2017), in this regard, suggest that researchers in this field should consider factors that can better explain the nature of the relationship between the two corporate practices. Keeping in view that very little is known about factors that affect the CSR and EQ relationship and based on our discussion on the relevancy of managerial entrenchment to study firms' CSR and EM practices (see, for example, Florackis & Ozkan, 2009; Surroca & Tribó, 2008; Villarón-Peramato et al., 2018; Zhao & Chen, 2008), this paper examines its moderating role in achieving the consensus.

2.2 | Managerial entrenchment, corporate social responsibility performance, and earnings quality

The literature to date has ignored the fundamental managerial aspect that can explain the relationship between CSR performance and EQ. A recent study by Walker (2013) provides a comprehensive review of existing literature that highlights various managerial incentives to manage earnings. However, the pursuit of these managerial objectives can lead to extremely negative results for managers as well as for the firm (Guan, Wright, & Leikam, 2005). To avoid such negative consequences, entrenched managers—those who expropriate wealth from the shareholders by pursuing their personal objectives but preserving their job position at the same time—use CSR to create a smokescreen (Cespa & Cestone, 2007). Despite the continuous efforts to minimize managerial discretion over reporting, modern-day reporting practices offer entrenched managers many opportunities to manipulate financial (Di Meo, Lara, & Surroca, 2017) and nonfinancial information (Cho et al., 2015). On the one hand, managers may engage in EM, and on the other hand, they may invest extensively in CSR to disguise their acts (Cumming, Hou, & Lee, 2016).

When managers are unable to generate sufficient shareholder value, they adopt other strategies to deter the threat of hostile takeover. Masking the actual firm performance by manipulating earnings has its incentives given that the participants in the capital market often rely on such information (Di Meo et al., 2017). Similarly, stakeholder satisfaction is also essential. The lack of support from stakeholders can increase the chances of a hostile takeover (Schneper & Guillén, 2004) and dismissal or replacement of CEOs (Surroca & Tribó, 2008). In this situation, managers adopt some powerful entrenchment strategies by establishing a friendly behavior or colluding with stakeholders (Cespa & Cestone, 2007). The objective is to gain stakeholders' support for channeling their efforts to the manager's advantage. Besides this, stakeholders can exercise their power via boards when the board has a stakeholder representation (Kock, Santaló, & Diestre, 2012).

A manager who is entrenched needs to protect himself from powerful stakeholders. Adopting a stakeholder-oriented behavior helps a firm in gaining legitimacy and stakeholder satisfaction. The motivation to increase stakeholder support and build a friendly relationship encourages these managers to engage in different social and environmental activities (Surroca & Tribó, 2008). Therefore, the CSR initiatives serve as a defensive and legitimacy tool as it helps the firm avoid adverse reactions of stakeholders who are affected by EM practices (Prior et al., 2008). It enables entrenched managers to pursue their own goals (cf., Surroca, Tribó, & Waddock, 2010). Keeping in view these facts, we assume that managerial entrenchment has a moderating role and can help improve the collective understanding of the CSR–EQ relationship. Therefore, we test the CSR performance and EM link in the presence of managerial entrenchment. Moreover, we consider both types of EM, namely accrual-based and real EM. Hence, we propose the following testable hypotheses:

H1 *With managerial entrenchment taken into consideration, CSR performance is positively related to accrual-based earnings management.*

H2 *With managerial entrenchment taken into consideration, CSR performance is positively related to real earnings management.*

2.3 | Managerial entrenchment and CSR decoupling

The institutional approach suggests that firms in the same institutional environment should behave in a similar manner (Reid & Toffel, 2009). However, in practice, this does not hold. Firms operating in the same industry behave differently, especially in terms of CSR issues (Berrone & Gomez-Mejia, 2009). While some may respond symbolically, others may respond substantively to the CSR requirements (Marquis & Toffel, 2011). The firm's internal factors, like managerial characteristics, could lead firms to different strategies and actions. Top executives or influential CEOs, in particular, play a central role in any firm's CSR decisions (Walls & Berrone, 2017).

Managers become entrenched when they are powerful. They may gain this power because of their dual roles as CEOs and chairperson (Jackling & Johl, 2009), long tenure, share ownership (Veprauskaite & Adams, 2013), or status as founders (Morck, Shleifer, & Vishny, 1988). According to the agency perspective, entrenched forms of CEO power may be used to advance self-interests rather than the interests of shareholders or stakeholders (Weisbach, 1988). Powerful entrenched CEOs may inhibit boards monitoring ability and influence boards' strategic decisions like an investment in CSR (Muttakin, Khan, & Mihret, 2018). The CSR engagement becomes part of their plan only if it helps them to gain economic benefits.

CSR investments are costly (Goss & Roberts, 2011) and have a long-term return horizon (Brooks & Oikonomou, 2018; Qiu, Shaukat, & Tharyan, 2016). The nonstockholding stakeholders mostly require firms to be ethically, socially, and environmentally responsible, which means managers have to direct critical resources toward long-term investments. Entrenched managers do not want to invest in CSR, yet meet the stakeholder needs at the same time. The possible reason could be to gain a personal reputation among stakeholders. To keep their self-service activities undercover, they have to symbolically show that the firm seriously takes up CSR issues (Villarón-Peramato et al., 2018). Furthermore, the absence of short term profitability associated with CSR investments motivates managers who are interested in immediate ROI to decouple internal and external CSR actions or in other words, to create a gap between CSR disclosure and performance (Sauerwald & Su, 2019; Tashman et al., 2019).

CSR reports, given its advantages, can represent as a symbolic form of CSR (Hawn & Ioannou, 2016). To gain legitimacy and create a desirable self-image among stakeholders, managers may misrepresent CSR performance in their CSR reports or misalign performance and disclosure. The easiest way to maintain short-termism and gain legitimacy is by overstating the nonfinancial performance (Mahoney, Thorne, Cecil, & LaGore, 2013), which creates a positive gap between disclosure and performance (Graafland & Smid, 2019). This situation is a cause of information asymmetry between the firm and stakeholders. The market reacts by penalizing such a firm as a hypocritical firm. In the process of decoupling CSR, managers not only fake the CSR performance (Crilly et al., 2012), but also sometimes understate the CSR performance in reports. Understatement creates a negative gap between disclosure and performance. Hawn and Ioannou (2016) point out various reasons for such behavior such as a firm is risk-averse and is not sure about the reaction of the market, has a policy of secrecy, is in the process of experimentation, and does not want to get the attention of other stakeholders and social movements, and so on. Whatever the reason is, financial markets and investors do not fully acknowledge a firm's CSR efforts in the absence of sufficient CSR information. They are less likely to reward the firm (Hawn & Ioannou, 2016). This shows that the CSR gap, whether positive or negative, is harmful to the firm.

Minor and Morgan (2011) show that CSR engagement has an insurance like effect. In the face of contrasting stakeholders' demands, this effect can be rewarding. It provides entrenched managers with an opportunity to misalign CSR disclosure and performance and to hide their unethical reporting behavior. In a nutshell, entrenched managers are involved not only in manipulating earnings numbers but also in creating another type of organizational façade, that is, the CSR gap. Therefore, we hypothesize that:

H3 *Keeping other things constant, managerial entrenchment is positively associated with the gap between CSR disclosure and CSR performance.*

3 | METHODOLOGY AND DATA

3.1 | Sample

We collected data from Thomson Reuters Eikon for a period of 10 years from 2007 to 2016 for all nonfinancial firms from America, Europe, the Middle East, Africa (EMEA), and Asia. The data is comprised of 3,594 companies from 31 stock indices. After excluding observations with missing financial, economic, and CSR information, we used a final sample of 9,746 firm-year observations for the analysis. Our study sample is composed of firms from 28 different countries: Australia, Belgium, Bermuda, Canada, China, Denmark, Finland, France, Germany, Hong Kong, Ireland, Italy, Japan, Luxembourg, Macau, Mexico, Netherlands, New Zealand, Norway, Papua New Guinea, Russia, Singapore, South Africa, Spain, Sweden, Switzerland, the United Kingdom, and the United States. Regarding the geographical distribution of the sample, the observations are not distributed homogeneously: 35.79% of the companies are from the USA, 12.58% Canada, 10.13% from Australia, and 9.38% from Japan, being the most representative countries of the sample. The rest of the observations are distributed more homogeneously among the rest of the countries analyzed.

3.2 | Measures

3.2.1 | Earnings management

In our study, we focus on both types of EM strategies that entrenched managers may use to meet or beat earnings' benchmarks. Managers can choose between accrual-based EM (AEM) and real EM (REM). According to Zang (2012), decisions to manage earnings through “real” actions precede those to manage earnings through accruals. Conventionally, studies have focused more on AEM because it is less costly in terms of negative effects and thus is preferred, whereas REM could be harmful to long-term competitiveness and future value (García-Osma, 2008). However, REM is also prevalent in practice (Graham, Harvey, & Rajgopal, 2005) as it cannot be easily detected (Cohen & Zarowin, 2010).

3.2.2 | Accruals earnings management (AEM)

According to the accounting literature, the component of an accrual adjustment that is discretionary should represent the management discretion, and therefore earnings manipulation. This measure was first introduced by Healy (1985) and DeAngelo (1988), although the study by Jones (1991) represented a landmark in this line of research. For our analysis, we adapted Jones' proposed model. Consistent with Prior et al. (2008), all models include dummy variables identifying the country of origin, because the sample size precludes estimating models by year, sector, and country.

Jones (1991) proposed that the components of accrual adjustments should be separated using a linear regression model. This model accounted for the total adjustment in terms of two variables: the change in sales and gross fixed assets. Subsequently, DeFond and Jiambalvo (1994) corrected the main drawback of the standard Jones model related to its use of time series and the need for a large number of observations per firm. They propose that the model should be obtained using annual cross-sectional data, grouping firms by sectors. Methodologically, we follow Jones (1991) and Dechow, Sloan, and Sweeney (1995). According to the modified Jones model, this study uses the change in sales minus accounts receivable (to capture the growth of the company, as working capital is linked to sales), less property, plant and equipment, as a measure of depreciation costs that are part of discretionary adjustments.

$$\frac{TAA_{it}}{A_{i,t-1}} = \propto_{1,t}\left(\frac{1}{A_{i,t-1}}\right) + \propto_{2,t}\left(\frac{\Delta(Sales - A^{*}R)_{it}}{A_{i,t-1}}\right) + \propto_{3,t}\left(\frac{PPE_{it}}{A_{i,t-1}}\right) + \varepsilon_t \quad (1)$$

In the above Model 1, $A^{*}R$ is a measure of accounts receivable; $A_{i,t-1}$ is firm *i*'s total assets at the end of year $t-1$, $Sales_{it}$ represents sales during year *t* for firm *i*; PPE_{it} represents property, plant, and equipment during year *t* for firm *i*, and ε_t is the error term. In the above model, the coefficients are calculated using the original Jones model (1991) and the modification is used only for the calculation of the nondiscretionary adjustments. In line with previous studies in the field of accounting, we calculate “AEM” as the absolute value of discretionary accruals. For robustness checks and better insights, we also use positive as well as negative discretionary accruals, that is, “Positive_AEM” and “Negative_AEM”.

3.2.3 | Real earnings management (REM)

In addition to AEM, firms manipulate real earnings as an alternative to AEM. Therefore, AEM and REM are substitutes, and either one can be used as a measure of manipulative behavior (Kim et al., 2012).

We follow Roychowdhury (2006) to estimates discretionary expenditure (advertising, R&D, and SG&A), abnormal levels of cash flows from operations, and production costs. Originally Dechow, Kothari, and Watts (1998) presented these models and had been widely used in accounting literature (see, for instance, Kim et al., 2012; Chen, Lin, & Lin, 2008; Cohen & Zarowin, 2010). We estimate the normal level of operating cash flows, expenditure, and production costs as follows[3]:

$$\frac{OCF_{it}}{A_{i,t-1}} = \propto_0 + \propto_{1,t}\left(\frac{1}{A_{i,t-1}}\right) + \propto_{2,t}\left(\frac{Sales_{it}}{A_{i,t-1}}\right) + \propto_{3,t}\left(\frac{\Delta Sales_{it}}{A_{i,t-1}}\right) + \varepsilon_t \quad (2)$$

In Model 2, OCF_{it} represents firm *i*'s operating cash flows for firm *i* in year *t*, determined by summing the net income, depreciation and amortization, and changes in current liabilities, minus changes in current assets; $\Delta Sales_{it}$ is firm *i*'s change in sales between year $t-1$ and year *t*; and the other variables are as defined in Model 1. The abnormal OCF is obtained as the residual from Model 2.

We calculate discretionary expenditure using the following model:

$$\frac{DISEXP_{it}}{A_{i,t-1}} = \propto_0 + \propto_{1,t}\left(\frac{1}{A_{i,t-1}}\right) + \propto_{2,t}\left(\frac{Sales_{it}}{A_{i,t-1}}\right) + \varepsilon_t \quad (3)$$

In the above Model 3, $DISEXP_{it}$ represents the discretionary expenditure of firm *i* in the current year. Abnormal discretionary expenditure is calculated as the difference between the actual values $\frac{DISEXP_{it}}{A_{i,t-1}}$, and the normal level predicted from Model 3.

$$\frac{PRODCOSTS_{it}}{A_{i,t-1}} = \propto_0 + \propto_{1,t}\left(\frac{1}{A_{i,t-1}}\right) + \propto_{2,t}\left(\frac{Sales_{it}}{A_{i,t-1}}\right) + \propto_{3,t}\left(\frac{\Delta Sales_{it}}{A_{i,t-1}}\right) + \propto_{3,t}\left(\frac{\Delta Sales_{it-1}}{A_{i,t-1}}\right) + \varepsilon_t \quad (4)$$

$$PRODCOSTS_{it} = COGS_{it} + \Delta INV_{it} \quad (4.1)$$

$$\frac{COGS_{it}}{A_{i,t-1}} = \propto_0 + \propto_{1,t}\left(\frac{1}{A_{i,t-1}}\right) + \propto_{2,t}\left(\frac{Sales_{it-1}}{A_{i,t-1}}\right) + \varepsilon_t \quad (4.2)$$

$$\frac{\Delta INV_{it}}{A_{i,t-1}} = \propto_{1,t}\left(\frac{1}{A_{i,t-1}}\right) + \propto_{2,t}\left(\frac{\Delta Sales_{it}}{A_{i,t-1}}\right) + \propto_{3,t}\left(\frac{\Delta Sales_{it-1}}{A_{i,t-1}}\right) + \varepsilon_t \quad (4.3)$$

where $PRODCOSTS_{it}$ is a measure of firm *i*'s production costs in year *t*, calculated as $COGS_{it} + \Delta INV_{it}$, where $COGS_{it} + \Delta INV_{it}$ is firm *i*'s cost of goods sold in year *t* and ΔINV_{it} is firm *i*'s change in inventories; the residual from Model 4 represents the abnormal production costs.

As proposed by Zang (2012), we combine these three measures into a comprehensive aggregate metrics of "REM." To do this, we multiply the abnormal cash flow from operations and abnormal discretionary expenses by minus one and aggregate these into a single measure. Following Cohen and Zarowin (2010), we do not multiply the abnormal production costs by minus one because higher production costs, as noted earlier, are indicative of over-production to reduce the cost of goods sold. The higher the value of this measure, the more likely the firm is to engage in sales manipulation and reduction of discretionary expenditure to boost reported earnings.

$$REM_{it} = (-AbnOCF_{it}) + (-AbnDISEXP_{it}) + AbnPRODCOSTS_{it} \quad (5)$$

3.2.4 | CSR performance

CSR performance was drawn from the ASSET4 database by using the Environmental, Social, and Governance (ESG) score (Muñoz-Torres, Fernández-Izquierdo, Rivera-Lirio, & Escrig-Olmedo, 2019; Wang, Hsieh, & Sarkis, 2018). ESG scores are designed to transparently and objectively measure a company's relative ESG performance, commitment, and effectiveness across various themes (emissions, environmental product innovation, human rights, shareholders, etc.) based on company-reported data. The ten main themes assessed to construct the ESG score are the following: (1) resource use score; (2) emissions score; (3) innovation score; (4) workforce score; (5) human rights score; (6) community score; (7) product responsibility score; (8) management score; (9) shareholders score; and (10) CSR strategy. Each theme is scored between 0 and 10; thus, "ESG" is in the range 0–100 and represents the CSR performance; higher scores indicate greater CSR achievements (Muñoz-Torres et al., 2019; Wang et al., 2018). Instead of using only the ES score, a global assessment of ESG score allows investors, analysts, and other stakeholders to evaluate how well firms are committed to CSR issues. As Wang et al. (2018) suggest, ESG provides a more comprehensive evaluation of CSR achievements rather than those scores focused only on social or environmental issues.

3.2.5 | CSR gap

For the operationalization of the CSR gap, we follow Hawn and Ioannou (2016)[4] and calculate the CSR gap measure as an absolute difference between the external and internal CSR actions. In our sample, some firms do have a negative gap between internal and external actions. The negative gap shows that some firms are performing better than they actually disclose. By using this construction of the decoupling indicator, we contribute toward studies like Luo, Wang, and Zhang (2017), who relied on the quality of CSR reporting for capturing the symbolic involvement with CSR.

3.2.6 | Managerial entrenchment

Following Bebchuk et al. (2009), we created an entrenchment index as the aggregate of six entrenchment provisions and termed as "Entrenchment". Each provision is measured on a binary scale. For the existence of provision, it takes value 1 and 0 otherwise. Accordingly, each firm in each year will have an entrenchment index score between 0 and 6. The six provisions are a measure of limiting shareholder rights and providing managers more and more discretion to make strategic decisions (Collins & Huang, 2011). The provisions are *(a)* staggered board: a board in which directors are divided into separate classes (typically three) with each class being elected to overlapping terms; *(b)* limitation on amending by laws: a provision limiting shareholders' ability through majority vote to amend the corporate by laws; *(c)* limitation on amending the charter: a provision limiting shareholders' ability through majority vote to amend the corporate charter; *(d)* supermajority to approve a merger: a requirement that requires more than a majority of shareholders to approve a merger; *(e)* golden parachute: a severance agreement that provides benefits to management/board members in the event of firing, demotion, or resignation following a change in control; and *(f)* poison pill: a shareholder right that is triggered in the event of an unauthorized change in control that typically renders the target company financially unattractive or dilutes the voting power of the acquirer.

Research on governance and EM as well as CSR shows that effective governance, on the one hand, improves financial reporting transparency (García-Meca & Sánchez-Ballesta, 2009) and, on the other hand, promotes CSR performance (Hussain et al., 2018). Keeping in view the existing evidence, we use the entrenchment index as an inverse proxy of governance effectiveness. We argue that a higher index score indicates ineffective governance and more managerial autonomy to misuse organizational resources.

3.2.7 | Control variables

To control for confounding factors, we included a set of control variables in the regression models. The selection of controls is in line with Dhaliwal, Radhakrishnan, Tsang, and Yang (2012) and is based on firm and institutional-level factors. We included the following firm-level indicators: "Size" measured as the natural logarithm of total assets; "ROA" measured as the return-on-assets ratio; "Market_cap" measured as the market to book ratio; "Leverage" measured as the total debt divided by total assets; "Analysts" measured as the number of financial analysts that follow a firm by year; and "WC," measured as the value of the difference between current assets and current liabilities.

Given that we have an international sample, we also include several institutional-level controls. We define four variables, "Culture", "STAKELAW", "CSRLAW", and "Enforcement" following Garcia-Sanchez, Cuadrado-Ballesteros, and Frias-Aceituno (2016). "Culture" represents the cultural system development as the mean score of the six cultural dimensions proposed by Hofstede.[5] "STAKELAW" and "CSRLAW" are two proxies developed by Dhaliwal et al. (2012) to represent stakeholder orientation. The first variable assesses the legal environment of a country concerning the protection of labor rights and benefits. "STAKELAW" is the average score of four indices obtained from Botero, Djankov, Porta, Lopez-de-Silanes, and Shleifer (2004). The "Enforcement" index captures the quality of the legal tradition (La Porta, Lopez-de-Silanes, Shleifer, & Vishny, 1997). It is formed by the mean value of two indices that are factors of shareholders and stakeholders' rights: *(a)* law and order and *(b)* efficiency of the judicial system. Finally, to control for variation across country, time, and industry, we include country, year, and industry dummies.

4 | RESULTS AND DISCUSSION

4.1 | Descriptive results

We apply various panel data regression models, with the decision regarding which analytic technique to be used depends on the nature of the dependent variable and the type of function that is proposed to relate *X* and *Y*. In this research, the dynamic panel estimator proposed by Arellano and Bond (1991), based on the generalized method of moments (GMM) introduced by Hansen (1982), is employed. Table 1 reports descriptive statistics and correlations for all the analyzed variables except the industry and year dummies. The main variables, "AEM" and "REM" show mean values of 0.21 and −0.06, respectively. The "ESG" is around 62 points of a possible range of 0–100, indicating that, on average, firms are committed toward CSR. The mean value of the CSR gap is above 0, which shows, on average, firms misalign CSR disclosure and performance. Regarding the control variables, for example, sample firms, on average, have a return on equity ratio around 2.4% and are followed by 16 financial analysts. Table 1 also reports the frequency of "Entrenchment" index values. We observe that few companies take values 5 and 6 for the entrenchment index which are associated with a golden parachute and poison pill (Bebchuk et al., 2009). These provisions are often used by firms to limit the shareholders' ability to affect the managerial discretion on strategic decisions. Panel B of the table reports the correlation matrix that shows a low or moderate correlation among variables. We do not find any high correlation coefficients between dependent and independent variables or between independent variables.

4.2 | Test of hypotheses

In this section, we present the results of all regression models. The results in Tables 2 and 3 confirm the moderating effect of managerial entrenchment on the relationship between CSR and EQ (accrual-based and real EM, respectively). We used Stata to run the GMM regression models. We report the coefficient and the standard error for each explanatory variable. We also provide the results of the Arellano–Bond test for AR (2) in the first differences and the Hansen test of over-identification restrictions.[6]

Table 2 provides evidence about accrual-based EM as an inverse proxy of EQ. In Model 6.1, the CSR performance indicator variable is negatively associated with accrual-based EM. While the entrenchment index is positively and significantly associated with EM practices, highlighting the high coefficient. The interaction between CSR performance and entrenchment "ESG*Entrenchment" is positive and significant. Our results reveal that the relationship between CSR performance and EM became positive in the presence of managerial entrenchment. This can be compared with our earlier result of the

TABLE 1 Descriptive statistics and correlation matrixes

Panel A. Mean and standard deviation of variables used in regressions

	Mean	*SD*		Values	Freq.	%
AEM	0.209	0.110	Entrenchment	1	1,251	16.41
REM	−0.060	0.083		2	2,059	27.03
ESG	62.367	26.944		3	1,134	14.87
CSR_Gap	0.360	0.261		4	1,890	24.79
Entrenchment	2.021	1.420		5	1,042	13.67
Size	27.967	6.909		6	246	3.23
ROA	2.410	3.230				
Market_cap	54.061	202.078				
Leverage	8.039	824.855				
Analysts	15.897	9.382				
WC	2,850.000	29,300.000				
Culture	23.270	2.470				
STAKELAW	0.699	0.848				
CSRLAW	12.910	4.552				
Enforcement	0.296	0.414				

Panel B. Bivariate correlations between variables used in regressions

	1	2	3	4	5	6	7	8	9	10	11	12	13	14	15
1. AEM	1.000														
2. REM	0.061	1.000													
3. ESG	0.000	0.010	1.000												
4. CSR_Gap	0.037	0.029	0.186	1.000											
5. Entrenchment	0.025	0.003	0.022	0.035	1.000										
6. Size	0.033	0.078	0.372	0.107	0.054	1.000									
7. ROA	−0.061	−0.007	−0.006	0.050	0.020	−0.017	1.000								
8. Market_cap	0.056	−0.105	−0.037	0.016	0.123	−0.090	−0.028	1.000							
9. Leverage	−0.001	0.001	0.016	−0.018	0.012	0.011	−0.004	−0.016	1.000						
10. Analysts	0.008	0.005	0.216	0.117	0.261	0.396	0.060	0.134	0.003	1.000					
11. WC	−0.005	0.017	0.071	0.029	−0.002	0.123	0.018	−0.029	0.010	0.081	1.000				
12. Culture	−0.002	0.009	0.004	0.014	0.134	0.003	0.035	0.040	0.005	0.050	−0.031	1.000			
13. STAKELAW	−0.028	0.009	−0.026	−0.001	−0.396	−0.170	−0.029	−0.105	0.004	−0.179	−0.061	0.326	1.000		
14. CSRLAW	−0.022	0.011	−0.016	0.031	−0.388	0.063	−0.015	−0.082	0.005	0.087	−0.018	−0.274	0.498	1.000	
15. Enforcement	−0.019	0.029	−0.081	−0.032	−0.390	−0.184	−0.025	−0.108	−0.001	−0.167	−0.035	−0.282	0.378	0.471	1.000

Note: Sample: 9,746 observations in 2007–2016.

TABLE 2 Regression analysis linking CSR performance, accrual earnings management, and managerial entrenchment

	Model 6.1				Model 6.1.1				Model 6.1.2			
	AEM				Positive_AEM				Negative_AEM			
	Coef.	*SE*	Coef.	*SE*	Coef.	*SE*	Coef.	*SE*	Coef.	*SE*	Coef.	*SE*
Main variables												
ESG	−.542***	0.175	−1.189***	0.255	−1.428***	0.278	−.669*	0.397	−1.505***	0.0724	−.323***	0.046
Entrenchment			3.441***	0.420			5.504***	0.737			39.567***	2.842
ESG*entrenchment			.339***	.083			0.694***	.130			1.583***	.109
Control variables												
Size	14.38***	1.073	10.889***	0.648	25.43***	1.507	11.887***	0.594	4.975**	2.102	2.611***	0.564
ROA	−1.08e − 09**	4.83e − 10	.000	0.000	−2.33e − 09***	7.08e − 10	.000**	0.000	1.79e − 09***	2.57e − 10	.000	0.000
Market_cap	.259***	0.0243	.177***	0.012	.379***	0.0308	.239***	0.013	.00139	0.0438	.019	0.024
Leverage	.00347***	0.000441	.002***	0.000	.00447***	0.00128	.005***	0.002	−.00484	0.00322	−.004***	0.000
Analysts	4.534***	0.724	−22.777***	6.031	7.716***	1.012	−39.522***	9.055	100.84***	0.631	6.999***	0.490
WC	.001***	0.000	.000***	0.000	.001***	0.000	.000***	0.000	.0000	0.0001	.000***	0.000
Culture	−11,496*	6,626	−.621**	0.257	−33,617***	7,997	−.772**	0.308	.0000	0.0001	−.779***	0.253
STAKELAW	10.21	52.32	28.720	20.669	88.60	66.49	.012***	29.228	−2.916	14.63	54.124***	19.237
CSRLAW	−34.75***	6.396	−18.626***	2.658	−54.81***	6.671	−31.201***	3.596	−20.61***	4.930	−17.012***	2.967
Enforcement	−9.280	101.2	−.002***	0.000	−41.24	57.91	−.002***	0.000	108.8***	34.01	131.959***	12.485
Controlled by country, year, and industry												
AR(2) Arellano-Bond test	Pr > *z* = 0.394		Pr > *z* = 0.185		Pr > *z* = 0.058		Pr > *z* = 0.217		Pr > *z* = 0.186		Pr > *z* = 0.100	
Hansen test	Prob > chi2 = 1.000		Prob > chi2 = 1.000		Prob > chi2 = 1.000		Prob > chi2 = 1.000		Prob > chi2 = 1.000		Prob > chi2 = 1.000	

Note: Sample: 9,746 observations in 2007–2016.
*, **, and *** represent statistical significance at 90, 95, and 99%, respectively.

TABLE 3 Regression analysis linking CSR performance, real earnings management, and managerial entrenchment

	Model 6.2				Model 6.2.1				Model 6.2.2				Model 6.2.3			
	REM				AbnOCF				AbnDISEXP				AbnPRODCOST			
	Coef.	*SE*	Coef.	*SE*	Coef.	*SE*	Coef.	*SE*	Coef.	*SE*	Coef.	*SE*	Coef.	*SE*	Coef.	*SE*
Main variables																
ESG	−19.67	27.55	22.922	15.149	−.00156***	0.000308	−.017*	0.009	−.00947***	0.00161	−.004**	0.002	19.66	27.55	−22.934	15.149
Entrenchment			8.236**	4.123			.000	0.000			.086*	0.050			4.802***	1.170
ESG*entrenchment			−6.104	5.009			0.000	.000			0.000	.001			6.107	5.009
Control variables																
Size	−862.2***	188.8	−.012***	0.039	.0138***	0.00180	.016***	0.001	−.0650***	0.00959	−.087***	0.004	862.2***	188.8	.116***	39,753
ROA	−3.07e − 08	4.43e − 08	.000*	0.000	.0000	0.0001	.000***	0.000	.0000	0.0001	.000***	0.000	3.07e − 08	4.43e − 08	.000*	0.000
Market_cap	−8.816***	2.772	−4.802***	1.170	−6.67e − 05**	2.97e − 05	.000**	0.000	.000645***	0.000157	.000***	0.000	8.817***	2.772	−.824**	0.412
Leverage	.784***	0.243	.261***	0.063	−2.71e − 07	3.98e − 07	.000**	0.000	4.36e − 06*	2.60e − 06	.000***	0.000	−.784***	0.243	−.261***	0.063
Analysts	149.3**	59.17	−54.242***	20.335	.00166***	0.000563	.002***	0.000	−.00412	0.00329	−.012***	0.002	−149.3**	59.17	54.233***	20.335
WC	.0000	0.0001	.000	0.000	.0000	0.0001	.000**	0.000	.0000	0.0001	.000***	0.000	.0000	0.0001	.000	0.000
Culture	−145,777	633	54.476*	29.464	12.55	9.268	3,303	3.892	−73.50	51.90	−21,188	21.597	145,665	633	−54.468*	29.465
STAKELAW	−893.6	5,166	−.568***	0.216	−.142**	0.0684	−.055*	0.031	.725*	0.385	.364**	0.169	894.5	5,166	.569***	0.216
CSRLAW	1,113	708.1	.093**	0.0371	.0389***	0.00983	.020***	0.005	−.251***	0.0541	−.124***	0.029	−1,113	708.1	−.093**	0.037
Enforcement	−9,562	9,269	−.231	0.385	−.170	0.164	−.208***	0.069	1,193	0.908	1.054***	0.381	9,562	9,27	.231	0.385
Controlled by country, year, and industry																
AR(2) Arellano-Bond test	Pr > *z* = 0.997		Pr > *z* = 0.227		Pr > *z* = 0.443		Pr > *z* = 0.409		Pr > *z* = 0.185		Pr > *z* = 0.432		Pr > *z* = 0.461		Pr > *z* = 0.227	
Hansen test	Prob > chi2 = 1.000		Prob > chi2 = 0.999		Prob > chi2 = 1.000		Prob > chi2 = 1.000		Prob > chi2 = 1.000		Prob > chi2 = 1.000		Prob > chi2 = 1.000		Prob > chi2 = 0.999	

Note: Sample: 9,746 observations in 2007–2016.
*, **, and *** represent statistical significance at 90, 95, and 99%, respectively.

TABLE 4 Regression analysis linking CSR gap, accrual earnings management, and managerial entrenchment

	Model 7 CSR_Gap		Model 8 AEM		Model 8.1 Postive_AEM		Model 8.2 Negative_AEM	
	Coef.	SE	Coef.	SE	Coef.	SE	Coef.	SE
Main variables								
Entrenchment	.521***	0.212						
CSR_Gap			.199***	0.038	.351***	0.023	.101***	0.009
Control variables	Included		Included		Included		Included	
Controlled by country, year, and industry								
AR(2) Arellano-Bond test	Pr > *z* = 0.128		Pr > *z* = 0.551		Pr > *z* = 0.318		Pr > *z* = 0.143	
Hansen test	Prob > chi2 = 1.000		Prob > chi2 = 1.000		Prob > chi2 = 1.000		Prob > chi2 = 1.000	

Note: Sample: 9,746 observations in 2007–2016.
*, **, and, *** represent statistical significance at 90, 95, and 99%, respectively.

negative direct relationship when managerial entrenchment was not in the model. This confirms our H1 and implies that the managerial entrenchment increases the manager's propensity to engage in the instrumental use of CSR.

Our results are consistent for the alternative dependent variables "Positive_AEM" and "Negative_AEM" in Models 6.1.1 and 6.1.2, respectively. The findings of both models show that the CSR performance is negatively associated with positive or negative EM, except when CSR interacts with managerial entrenchment. Thus, we again support the moderating effect of managerial entrenchment on the relationship between CSR and EM.

Table 3 shows the results of the relationships between CSR performance, managerial entrenchment, and real-based EM. In Model 6.2, we note that the CSR performance does not significantly explain changes in the REM and only the entrenchment index is positively and significantly associated with REM. Additionally, we did not observe the moderating effect of managerial entrenchment as the results for the relevant variable are insignificant ($\delta_3 = -6.104$, $p > .10$). Therefore, we are unable to support our H2.

To further our understanding regarding the relationship between CSR and REM, we run three additional models where we use each component of "REM" as a dependent variable, namely "AbnOCF", "AbnDISEXP", and "AbnPRODCOST". Results are similar to those previously reported for the main REM measure. Interestingly, we note that CSR performance is negatively and significantly associated with "AbnOCF" and "AbnDISEXP." Therefore, in contrast to our expectations, we cannot support that the managerial entrenchment moderates the impact of CSR commitment on REM.

Tables 4 and 5 provide evidence about the relationship between managerial entrenchment and the CSR gap, as well as between the CSR gap and EM and REM. In Model 7, the managerial entrenchment indicator variable is positively associated with "CSR_Gap." This result supports our H3 and indicates that the entrenched management of any company is more prone to decouple CSR disclosure and CSR performance.

Additionally, in Table 4 (Model 8, 8.1, and 8.2), we further report the results of CSR with the three manifestations of AEM as follows, where "AEM" as the dependent variable is replaced with positive and negative discretionary accruals. The "CSR_Gap" measure is positively and significantly associated with the overall measure of AEM. In terms of positive and negative accruals, we note that "CSR_Gap" is significantly associated with both measures of AEM at 1% significance level. In Table 5, we present the results of the relationship between the CSR gap and REM. It also shows the results of the relationship between the CSR gap and the three components of REM: abnormal operating cash flow (Model 9.1), discretionary expenses (Model 9.2), and production costs (Model 9.3). The results confirm that the CSR gap is significantly and positively associated with REM. This further strengthens our idea of the instrumental use of CSR investment.

As a robustness check, we break down the managerial entrenchment index into four categories according to the provisions used to calculate it. Given the lower frequency of Provision 5 and 6 associated with golden parachutes and poison pills, respectively, we merge Provision 4, 5, and 6 into one. Thus, we aim to examine the following models in Model 10 (where AEM is the dependent variable in Model 10.1 and REM is the dependent variable in Model 10.2) and report the results in Table 6.

The results of both models show that CSR performance is negatively and significantly linked to AEM and REM. In addition, each of the components of the entrenchment index shows a positive and significant impact on AEM and REM except the "Entrenchment_3", which is insignificant. Interestingly, the interaction terms between "ESG" and individual provisions of the entrenchment index show significant positive relationships with accrual and real EM measures.

Our results hence support that the CSR-AEM and CSR-REM relationships become positive when "ESG" interacts with the entrenchment provisions; otherwise, these associations are always negative. For instance, if we focus on those firms that have the limitation on amending by laws—the second provision of entrenchment index—the previous negative direct impact of CSR performance on AEM converts to the positive influence. Contrary to results in Table 3, we note that the individual entrenchment provisions provide support to the fact that increased managerial entrenchment promotes a positive relationship between CSR performance and both types of EM strategies.

TABLE 5 Regression analysis linking CSR gap, accrual earnings management, and managerial entrenchment

	Model 9 REM		Model 9.1 AbnOCF		Model 9.2 AbnDISEXP		Model 9.3 AbnPRODCOST	
	Coef.	***SE***	**Coef.**	***SE***	**Coef.**	***SE***	**Coef.**	***SE***
Main variables								
CSR_Gap	.785***	0.201	.001**	0.000	.785***	0.201	.001***	0.000
Control variables	Included		Included		Included		Included	
Controlled by country, year, and industry								
AR(2) Arellano-Bond test	Pr > *z* = 0.148		Pr > *z* = 0.380		Pr > *z* = 0.148		Pr > *z* = 0.396	
Hansen test	Prob > chi2 = 0.993		Prob > chi2 = 1.000		Prob > chi2 = 0.993		Prob > chi2 = 0.999	

Note: Sample: 9,746 observations in 2007–2016.
*, **, and *** represent statistical significance at 90, 95, and 99%, respectively.

TABLE 6 Complementary analysis

	Model 10.1 AEM		Model 10.2 REM	
	Coef.	***SE***	**Coef.**	***SE***
Main variables				
ESG	−4.535***	0.936	−.705***	.231
Entrenchment_1	.446***	0.0104	8.389***	2.578
Entrenchment_2	.358***	75.717	6.715***	1.916
Entrenchment_3	.109	78.202	8.145***	2.187
Entrenchment_4–6	.377***	73.281	4.410**	1.910
ESG*Entrenchment_1	5.570***	1.377	.909***	.314
ESG*Entrenchment_2	7.500***	1.067	.751***	.245
ESG*Entrenchment_3	1.958*	1.093	.939***	.272
ESG*Entrenchment_4–6	3.908***	0.992	.456*	.241
Control variables	Included		Included	
Controlled by country, year, and industry				
AR(2) Arellano-Bond test	Pr > *z* = 0.106		Pr > *z* = 0.675	
Hansen test	Prob > chi2 = 1.000		Prob > chi2 = 0.959	

Note: Regression analysis linking CSR performance, earnings management, and managerial entrenchment components. Sample: 9,746 observations in 2007–2016.
*, **, and *** represent statistical significance at 90, 95, and 99%, respectively.

Summarizing all results, we support the prior literature that argues for a negative relationship between real CSR engagement and EM. Hence, our results help generate consensus about the nature of the underlying relationship. Moreover, with the managerial entrenchment taken into consideration, CSR performance is positively related to accrual-based and real EM. Hence, we support the moderating role of managerial entrenchment. We also find that managerial entrenchment is positively and significantly associated with the CSR gap. Furthermore, the results indicate that a firm's CSR decoupling is strongly linked to all the measures of EM. Moreover, First, in line with findings of Kim et al. (2012), Gao and Zhang (2015), Chen et al. (2018), Liu et al. (2017) and others; we confirm a positive relationship between CSR performance and EQ—a negative relationship to accrual-based EM measures. This shows that firms with high levels of CSR commitment behave in an ethical manner than companies that exhibit low levels of CSR commitment (Hong & Anderson, 2011; Gao & Zhang, 2015).

Secondly, we support the underlying idea of Gond et al. (2009) about the entrenched managers' use of financial and nonfinancial organizational practices instrumentally. In this vein, as Cho et al. (2015) highlight, we report that entrenched managers opportunistically invest more in CSR to camouflage their unethical financial reporting practices. Furthermore, we find that managerial entrenchment promotes the creation of organizational facades related to CSR. This is also in line with the argument of Prior et al. (2008) that managers use CSR as a tool to mask their unethical entrenchment actions. Our results further support that the entrenched managers use CSR to create a rosy picture when they are engaged in manipulating the earning numbers (Cespa & Cestone, 2007; Cumming et al., 2016). In this regard, results are also supported by the positive effect of managerial entrenchment of EM (accrual-based and real-based EM actions). Although the prior literature did not pay much attention to managerial entrenchment as a determinant of any EM strategy, we support that entrenchment acts as a valid driver of accrual-based and real-based EM.

We also note that the moderating effect of managerial entrenchment on the relationship between CSR and EQ is more prevalent in specific EM strategies. Although several authors have considered accrual-based and real practices of EM, the results obtained in the present study vary depending on the measure of EM taken. We do not provide the evidence about the moderating effect of managerial entrenchment in the combined real EM proxy except in the complementary analysis when we break down the entrenchment index into its sub-indices. The possible reasons for the difference in results depend on the EM strategies employed by the entrenched managers. We find weak support for the hypothesized relationship with REM. REM is considered costlier and detrimental to firms' competitiveness and future value, which hinders even entrenched managers from engaging in such manipulations (García-Osma, 2008). However, our results concerning CSR_Gap and EM measures are robust. CSR_Gap measure, significantly affected by the existence of managerial entrenchment, shows a consistently positive relationship with all measures of EM. These results strengthen our basic premise that managerial entrenchment is a contingent factor that affects CSR-EM relationship.

5 | CONCLUDING REMARKS

The study aims to examine the effect of management entrenchment on the relationship between CSR practices and EM and on the gap between CSR disclosure and CSR performance. The analysis of the longitudinal data of large international listed companies confirms a negative association between CSR performance and the use of EM strategies by firms. This suggests that firms that demonstrate high levels of CSR commitment are less involved in manipulating their earnings. The firms that decouple their CSR performance from CSR disclosure are manipulating earnings more than their counterparts whose CSR performance is aligned with CSR disclosure. Moreover, we find strong support that managerial entrenchment is a crucial factor that affects the underlying CSR-EM relationship. It moderates the link and increases a firm's propensity to engage in creating CSR-related organizational facades.

Theoretically, this study contributes to the stakeholder and legitimacy frameworks by suggesting that the engagement in the CSR activities has a spillover effect on the ethical reporting behavior of firms. This ethical behavior can help firms to achieve and maintain legitimacy in the financial market. In the presence of weak governance, entrenched managers mask their unethical reporting behavior by either investing more in CSR and manipulate earnings or by creating CSR-related facades. At the same time, they engage heavily in managing EM. The ethical premise of the stakeholder theory suggests that firms that are genuinely committed to CSR should have more credible financial and nonfinancial information. This means that firms with high levels of CSR performance are more likely to report their earnings ethically and less opportunistically than companies that exhibit low levels of CSR performance.

We also contribute to the literature of corporate governance (see, Bebchuk et al., 2009; García-Meca & Sánchez-Ballesta, 2009) by showing that when the governance is weak, the managers have the opportunity to use CSR practices to mask their unethical reporting behavior. Moreover, weak governance gives birth to more entrenched management that resultantly can use financial and nonfinancial information for achieving their own objectives. These results can provide a substantial input for governance regulations and hence also offer practical implications. Based on our findings, we argue that strong governance can make firms more transparent, ethical, and truly responsible. When firms are heavily investing in CSR, that can serve as an indication of the opportunistic behavior of firms. This is especially true when the quality of reported earnings is lower, governance is weak, and managers have ample opportunities to seek personal goals.

This research is subjected to certain limitations that can be addressed in future research. To generalize the findings beyond the listed firms, it is recommended that researchers test our evidence with nonlisted and small and medium-sized companies and examine the underlying relationships in the context of greater stakeholder or shareholder protections, different legal systems, and cultural values, and so forth. Another limitation is related to EM measures that ignore the differences in the accounting standards at the country level. Future research may examine how country-level governance and reporting standards moderate the relationship between CSR and EM. This study considers only the global construct of CSR. Future studies can use individual dimensions of CSR like resource use, innovation, workforce or human rights scores, etc. Finally, future research may examine the impact of CSR on other corporate practices like tax avoidance and tax sheltering.

ORCID

Isabel-Maria García-Sánchez https://orcid.org/0000-0003-4711-8631
Nazim Hussain https://orcid.org/0000-0003-2873-5001
Sana Akbar Khan https://orcid.org/0000-0002-7633-8177
Jennifer Martínez-Ferrero https://orcid.org/0000-0001-8387-1466

ENDNOTES

[1] CSR, in general, reflects both actions of a firm.

[2] Following Dechow, Ge, and Schrand (2010) and Kim et al. (2012), we assume EM as being a negative measure of EQ, as EM through discretionary accounting policies reduces the usefulness of accounting information.

[3] Similar to "AEM" models, for estimating REM measures, all models include dummy variables identifying the country of origin, the year, and the activity sector.

[4] The operationalization provided by Hawn and Ioannou (2016) of CSR gap is based on the absolute difference between 24 external items and 21 internal items derived from the Thomson Reuter's Asset4 score of environmental, social, and governance matrix. We follow the same technique to calculate an absolute gap between the external and internal actions of each firm for each year. The gap between external and internal actions is the absolute value of the difference

CSR_GAP$_{it}$ = External$_{it}$ − Internal$_{it-1}$, accounting for the misalignment in both types of actions.

[5] To construct the measure of "Culture", we followed Martínez-Ferrero and García-Sánchez (2017).

[6] The former is a test of second-order serial correlation in the first-differenced residuals, asymptotically distributed as *N* (0, 1) under the null hypothesis that there is no serial correlation of the error terms; the second is a test of the validity of the over-identifying restrictions for the GMM estimator, asymptotically distributed as chi^2, under the null hypothesis that the over-identifying restrictions are valid.

REFERENCES

Abrahamson, E., & Baumard, P. (2008). What lies behind organizational façades and how organizational façades lie: An untold story of organizational decision making. In G. Gerard, P. Hodgkinson, & W. H. Starbuck (Eds.), *The Oxford Handbook of Organizational Decision Making* (pp. 437–452). Oxford: Oxford University Press.

Arellano, M., & Bond, S. (1991). Some tests of specification for panel data: Monte Carlo evidence and an application to employment equations. *Review of Economic Studies*, *58*, 277–297.

Bebchuk, L., Cohen, A., & Ferrell, A. (2009). What matters in corporate governance? *The Review of Financial Studies*, *22*(2), 783–827.

Berrone, P., & Gomez-Mejia, L. R. (2009). Environmental performance and executive compensation: An integrated agency-institutional perspective. *Academy of Management Journal*, *52*(1), 103–126.

Bertels, S., & Peloza, J. (2008). Running just to stand still? Managing CSR reputation in an era of ratcheting expectations. *Corporate Reputation Review*, *11*(1), 56–72.

Bilal, C. S., & Komal, B. (2018). Audit committee financial expertise and earnings quality: A meta-analysis. *Journal of Business Research*, *84*, 253–270.

Botero, J. C., Djankov, S., Porta, R. L., Lopez-de-Silanes, F., & Shleifer, A. (2004). The regulation of labor. *Quarterly Journal of Economics*, *119*(4), 1339–1382.

Brooks, C., & Oikonomou, I. (2018). The effects of environmental, social and governance disclosures and performance on firm value: A review of the literature in accounting and finance. *The British Accounting Review*, *50*(1), 1–15.

Carroll, A. B. (1979). A three-dimensional conceptual model of corporate performance. *Academy of Management Review*, *4*(4), 497–505.

Cespa, G., & Cestone, G. (2007). Corporate social responsibility and managerial entrenchment. *Journal of Economics & Management Strategy*, *16* (3), 741–771.

Chen, C., Gotti, G., Kang, T., & Wolfe, M. C. (2018). Corporate codes of ethics, National Culture, and earnings discretion: International evidence. *Journal of Business Ethics*, *151*(1),141–163.

Chen, C., Lin, C., & Lin, Y. (2008). Audit partner tenure, audit firm tenure, and discretionary accruals: Does long auditor tenure impair earnings quality? *Contemporary Accounting Research*, *25*(2), 447–471.

Chih, H. L., Shen, C. H., & Kang, F. C. (2008). Corporate social responsibility, investor protection, and earnings management: Some international evidence. *Journal of Business Ethics*, *79*(1–2), 179–198.

Cho, C. H., Laine, M., Roberts, R. W., & Rodrigue, M. (2015). Organized hypocrisy, organizational façades, and sustainability reporting. *Accounting, Organizations and Society*, *40*, 78–94.

Christensen, L. T., Morsing, M., & Thyssen, O. (2013). CSR as aspirational talk. *Organization*, *20*(3), 372–393.

Cohen, D. A., & Zarowin, P. (2010). Accrual-based and real earnings management activities around seasoned equity offerings. *Journal of Accounting and Economics*, *50*(1), 2–19.

Collins, D., & Huang, H. (2011). Management entrenchment and the cost of equity capital. *Journal of Business Research*, *64*(4), 356–362.

Crilly, D., Zollo, M., & Hansen, M. T. (2012). Faking it or muddling through? Understanding decoupling in response to stakeholder pressures. *Academy of Management Journal*, *55*(6), 1429–1448.

Cumming, D., Hou, W., & Lee, E. (2016). Business ethics and finance in greater China: Synthesis and future directions in sustainability, CSR, and fraud. *Journal of Business Ethics*, *138*(4), 601–626.

DeAngelo, L. E. (1988). Managerial competition, information costs, and corporate governance. The use of accounting performance measures in proxy contests. *Journal of Accounting and Economics*, *10*(1), 3–36.

Dechow, P. M., Sloan, R. G., & Sweeney, A. P. (1995). Detecting earnings management. *Accounting Review*, *70*(2), 193–225.

Dechow, P. M., Kothari, S. P., & Watts, R. L. (1998). The relation between earnings and cash flows. *Journal of Accounting and Economics*, *25*(2), 133–168.

Dechow, P., Ge, W., & Schrand, C. (2010). Understanding earnings quality: A review of the proxies, their determinants and their consequences. *Journal of Accounting and Economics*, *50*(2–3), 344–401.

DeFond, M. L., & Jiambalvo, J. (1994). Debt covenant violation and manipulation of accruals. *Journal of Accounting and Economics*, *17*(1–2), 145–176.

Dhaliwal, D. S., Radhakrishnan, S., Tsang, A., & Yang, Y. G. (2012). Nonfinancial disclosure and analyst forecast accuracy: International evidence on corporate social responsibility disclosure. *The Accounting Review*, *87*(3), 723–759.

Di Meo, F., Lara, J. M. G., & Surroca, J. A. (2017). Managerial entrenchment and earnings management. *Journal of Accounting and Public Policy*, *36* (5), 399–414.

Florackis, C., & Ozkan, A. (2009). The impact of managerial entrenchment on agency costs: An empirical investigation using UKpanel data. *European Financial Management*, *15*(3), 497–528.

Gao, L., & Zhang, J. H. (2015). Firms' earnings smoothing, corporate social responsibility, and valuation. *Journal of Corporate Finance*, *32*, 108–127.

García-Osma, B. (2008). Board independence and real earnings management: The case of R&D expenditure. *Corporate Governance: An International Review*, *16*(2), 116–131.

Garcia-Sanchez, I. M., Cuadrado-Ballesteros, B., & Frias-Aceituno, J. V. (2016). Impact of the institutional macro context on the voluntary disclosure of CSR information. *Long Range Planning*, *49*(1), 15–35.

García-Meca, E., & Sánchez-Ballesta, J. P. (2009). Corporate governance and earnings management: A meta-analysis. *Corporate Governance: An International Review*, *17*(5), 594–610.

Gond, J. P., Palazzo, G., & Basu, K. (2009). Reconsidering instrumental corporate social responsibility through the mafia metaphor. *Business Ethics Quarterly*, *19*(1), 57–85.

Goss, A., & Roberts, G. S. (2011). The impact of corporate social responsibility on the cost of bank loans. *Journal of Banking & Finance*, *35*(7), 1794–1810.

Graafland, J., & Smid, H. (2019). Decoupling among CSR policies, programs, and impacts: An empirical study. *Business & Society*, *58*(2), 231–267.

Graham, J. R., Harvey, C. R., & Rajgopal, S. (2005). The economic implications of corporate financial review of the empirical disclosure literature. *Journal of Accounting and Economics*, *40*(1–3), 3–73.

Grougiou, V., Leventis, S., Dedoulis, E., & Owusu-Ansah, S. (2014). Corporate social responsibility and earnings management in US banks. *Accounting Forum*, *38*(3), 155–169.

Guan, L., Wright, C. J., & Leikam, S. L. (2005). Earnings management and forced CEO dismissal. *Advances in Accounting*, *21*, 61–81.

Hansen, L. (1982). Large sample properties of generalized method of moments estimators. *Econometrica*, *50*(3), 1029–1054.

Hawn, O., & Ioannou, I. (2016). Mind the gap: The interplay between external and internal actions in the case of corporate social responsibility. *Strategic Management Journal*, *37*(13), 2569–2588.

Healy, P. M. (1985). The effect of bonus schemes on accounting decisions. *Journal of Accounting and Economics*, *7*(1–3), 85–107.

Healy, P. M., & Wahlen, J. M. (1999). A review of the earnings management literature and its implications for standard setting. *Accounting Horizons*, *13*(4), 365–383.

Hinze, A. K., & Sump, F. (2019). Corporate social responsibility and financial analysts: A review of the literature. *Sustainability Accounting, Management and Policy Journal*, *10*(1), 126–156.

Hong, Y., & Andersen, M. L. (2011). The relationship between corporate social responsibility and earnings management: An exploratory study. *Journal of Business Ethics*, *104*, 461–471.

Hussain, N., Rigoni, U., & Orij, R. P. (2018). Corporate governance and sustainability performance: Analysis of triple bottom line performance. *Journal of Business Ethics*, *149*(2), 411–432.

Jackling, B., & Johl, S. (2009). Board structure and firm performance: Evidence from India's top companies. *Corporate Governance: An International Review*, *17*(4), 492–509.

Jensen, M. (2004). Who gets wall Street's attention? How alliance announcements and alliance density affect analyst coverage. *Strategic Organization*, *2*(3), 293–312.

Jones, J. J. (1991). Earnings management during import relief investigations. *Journal of Accounting Research*, *29*(2), 193–228.

Jones, T. M. (1980). Corporate social responsibility revisited, redefined. *California Management Review*, *22*, 59–67.

Kim, Y., Park, M. S., & Wier, B. (2012). Is earnings quality associated with corporate social responsibility? *The Accounting Review*, *87*(3), 761–796.

Klein, A. (2002). Audit committee, board of director characteristics, and earnings management. *Journal of Accounting and Economics*, *33*(3), 375–400.

Kock, C. J., Santaló, J., & Diestre, L. (2012). Corporate governance and the environment: What type of governance creates greener companies? *Journal of Management Studies*, *49*(3), 492–514.

La Porta, R., Lopez-de-Silanes, F., Shleifer, A., & Vishny, R. W. (1997). Legal determinants of external finance. *Journal of Finance*, *52*, 1131–1150.

Lin, J. W., & Hwang, M. I. (2010). Audit quality, corporate governance, and earnings management: A meta-analysis. *International Journal of Auditing*, *14*(1), 57–77.

Liu, M., Shi, Y., Wilson, C., & Wu, Z. (2017). Does family involvement explain why corporate social responsibility affects earnings management? *Journal of Business Research*, *75*, 8–16.

Luo, X. R., Wang, D., & Zhang, J. (2017). Whose call to answer: Institutional complexity and firms' CSR reporting. *Academy of Management Journal*, *60*(1), 321–344.

Mahoney, L. S., Thorne, L., Cecil, L., & LaGore, W. (2013). A research note on standalone corporate social responsibility reports: Signaling or greenwashing? *Critical Perspectives on Accounting*, *24*(4–5), 350–359.

Marquis, C., and Toffel, M. 2011. *The globalization of corporate environmental disclosure: Accountability or greenwashing?* Harvard Business School Working Paper, No. 11–115.

Martínez-Ferrero, J., & García-Sánchez, I. M. (2017). Coercive, normative and mimetic isomorphism as determinants of the voluntary assurance of sustainability reports. *International Business Review*, *26*(1), 102–118.

Martínez-Ferrero, J., Banerjee, S., & García-Sánchez, I. M. (2016). Corporate social responsibility as a strategic shield against costs of earnings management practices. *Journal of Business Ethics*, *133*(2), 305–324.

Minor, D., & Morgan, J. (2011). CSR as reputation insurance: Primum non nocere. *California Management Review*, *53*(3), 40–59.

Morck, R., Shleifer, A., & Vishny, R. W. (1988). Management ownership and market valuation: An empirical analysis. *Journal of Financial Economics*, *20*(1–2), 293–315.

Muñoz-Torres, M. J., Fernández-Izquierdo, M. Á., Rivera-Lirio, J. M., & Escrig-Olmedo, E. (2019). Can environmental, social, and governance rating *agencies favor business models that promote a more sustainable development? Corporate Social Responsibility and Environmental Management*, *26*(2), 439–452.

Muttakin, M. B., Khan, A., & Mihret, D. G. (2018). The effect of board capital and CEO power on corporate social responsibility disclosures. *Journal of Business Ethics*, *150*(1), 41–56.

Pope, S., & Wæraas, A. (2016). CSR-washing is rare: A conceptual framework, literature review, and critique. *Journal of Business Ethics*, *137*(1), 173–193.

Prior, D., Surroca, J., & Tribó, J. A. (2008). Are socially responsible managers really ethical? Exploring the relationship between earnings management and corporate social responsibility. *Corporate Governance: An International Review*, *16*(3), 160–177.

Qian, C., Gao, X., & Tsang, A. (2015). Corporate philanthropy, ownership type, and financial transparency. *Journal of Business Ethics*, *130*(4), 851–867.

Qiu, Y., Shaukat, A., & Tharyan, R. (2016). Environmental and social disclosures: Link with corporate financial performance. *The British Accounting Review*, *48*(1), 102–116.

Reid, E. M., & Toffel, M. W. (2009). Responding to public and private politics: Corporate disclosure of climate change strategies. *Strategic Management Journal*, *30*(11), 1157–1178.

Roychowdhury, S. (2006). Earnings management through real activities manipulation. *Journal of Accounting and Economics*, *42*(3), 335–370.

Sauerwald, S., & Su, W. (2019). CEO overconfidence and CSR decoupling. *Corporate Governance: An International Review*, *27*, 283–300.

Schneper, W. D., & Guillén, M. F. (2004). Stakeholder rights and corporate governance: A cross-national study of hostile takeovers. *Administrative Science Quarterly*, *49*(2), 263–295.

Scholtens, B., & Kang, F. C. (2013). Corporate social responsibility and earnings management: Evidence from Asian economies. *Corporate Social Responsibility and Environmental Management*, *20*(2), 95–112.

Surroca, J., & Tribó, J. A. (2008). Managerial entrenchment and corporate social performance. *Journal of Business Finance & Accounting*, *35*(5–6), 748–789.

Surroca, J., Tribó, J. A., & Waddock, S. (2010). Corporate responsibility and financial performance: The role of intangible resources. *Strategic Management Journal*, *31*(5), 463–490.

Tashman, P., Marano, V., & Kostova, T. (2019). Walking the walk or talking the talk? Corporate social responsibility decoupling in emerging market multinationals. *Journal of International Business Studies*, *50*(2), 153–171.

Vansant, B. (2016). Institutional pressures to provide social benefits and the earnings management behavior of nonprofits: Evidence from the US hospital industry. *Contemporary Accounting Research*, *33*(4), 1576–1600.

Veprauskaite, E., & Adams, M. (2013). Do powerful chief executives influence the financial performance of U.K. firms? *The British Accounting Review*, *45*(3), 229–241.

Villarón-Peramato, Ó., Martínez-Ferrero, J., & García-Sánchez, I. M. (2018). CSR as entrenchment strategy and capital structure: Corporate governance and investor protection as complementary and substitutive factors. *Review of Managerial Science*, *12*(1), 27–64.

Walker, M. (2013). How far can we trust earnings numbers? What research tells us about earnings management. *Accounting and Business Research*, *43*(4), 445–481.

Walls, J. L., & Berrone, P. (2017). The power of one to make a difference: How informal and formal CEO power affect environmental sustainability. *Journal of Business Ethics*, *145*(2), 293–308.

Wang, X., Cao, F., & Ye, K. (2016). Mandatory corporate social responsibility (CSR) reporting and financial reporting quality: Evidence from a quasi-natural experiment. *Journal of Business Ethics*, *152*, 1–22. https://doi.org/10.1007/s10551-016-3296-2

Wang, Z., Hsieh, T. S., & Sarkis, J. (2018). CSR performance and the readability of CSR reports: Too good to be true? *Corporate Social Responsibility and Environmental Management*, *25*(1), 66–79.

Weisbach, M. S. (1988). Outside directors and CEO turnover. *Journal of Financial Economics*, *20*, 431–460.

Zang, A. (2012). Evidence on the tradeoff between real manipulation and accrual manipulation. *The Accounting Review*, *87*(2), 675–703.

Zhao, Y., & Chen, K. H. (2008). Staggered boards and earnings management. *The Accounting Review*, *83*(5), 1347–1381.

How to cite this article: García-Sánchez I-M, Hussain N, Khan SA, Martínez-Ferrero J. Managerial entrenchment, corporate social responsibility, and earnings management. *Corp Soc Responsib Environ Manag*. 2020;27:1818–1833. https://doi.org/10.1002/csr.1928